



**Response by Energia to SEM Committee
Consultation Paper
SEM/17/026**

I-SEM: Balancing Market Principles Code of Practice

12 May 2017

1. Introduction

Energia welcomes the opportunity to respond to this Single Electricity Market Committee (SEM Committee) consultation paper on the I-SEM Balancing Market Principles Code of Practice (BMPCoP). This consultation paper follows from Decision Paper SEM/17/020 where the SEM Committee set out its proposals for the regulation of the Balancing Market and identified consequential changes which would be required to, among others, replace the Bidding Code of Practice (BCoP) with the BMPCoP. For the reasons explained by Energia in its submissions to the preceding consultation paper (SEM/16/059), Energia has fundamental concerns with the approach being followed by the SEM Committee in respect of the regulation of the Balancing Market, including the form and role of the BMPCoP, and this response to consultation is not, and cannot be interpreted as, acceptance by Energia of SEM/17/020. Please note that all of Energia's rights in respect of SEM/17/020, including the right to take legal action as appropriate, are hereby strictly reserved.

The structure of this response is to first consider the BCMCoP in the context of the stated primary objective of the document; “to replicate competitive complex bid offer submissions in situations where sufficient competitive pressure is not always expected to be present”¹. This is an important precursor to the specific issues upon which comment has been requested. A brief summary of the SEM Committee’s decision in SEM/17/020 is provided in Section 3. Section 4 presents a detailed assessment of the proposed BMPCoP vis-à-vis the current arrangements that the SEM Committee consider to have been effective at mitigating market power, including local market power in SEM². Section 5 introduces a number of other issues with the consultation paper and proposed BMPCoP, including errors, inconsistencies and omissions. Finally, a summary and conclusions are presented in Section 6.

2. Replicating Competitive Bid/Offer Submissions

On a number of occasions, including in the preceding decision paper (SEM/17/020), the SEM Committee state that the primary objective of the proposed BMPCoP, “*is to replicate competitive bid offer submissions in situations where sufficient competitive pressure is not always expected to be present*”³. There are a number of issues with this overly-simplistic assessment of markets and competition, including:

- (i) that there is no uniquely defined “competitive market price” for imperfectly competitive markets that are characterised by significant constraints and a lumpy, long-term investment cycle;

and,

- (ii) that the SEM Committee appear to assume that the market exhibits a surplus of generation capacity and hence is oversupplied, and that SRMC is therefore the appropriate benchmark. However, this is often and manifestly not the case in the some areas of the I-SEM.

¹ SEM/17/020 at para 6.3.1 & SEM/17/026 at para 1.2.1

² SEM/16/024 at para 7.1.2 and SEM/16/059 at p.13

³ SEM/17/020 at para 6.3.1 & SEM/17/026 at para 1.2.1

Furthermore, the SEM Committee's statement implies an expectation that complex offers/bids will be equivalent, in quantum (€/£), to the bids/offers in the I-SEM ex-ante markets⁴ (Day-ahead and Intraday) and the Balancing Market (BM) (energy)⁵ where the SEM Committee has deemed there to be a sufficient level of competition. If these markets are deemed to be competitive by the SEM Committee, they should exhibit competitive market outcomes and the corresponding bids/offers should be directly comparable to the bids/offers in the highly-regulated and prescriptive I-SEM BM (non-energy) that is purportedly designed to replicate competitive market behaviour.

Elsewhere the SEM Committee states that it is the Committee's belief that, "*the proposed I-SEM arrangements provide a reasonable opportunity for efficient generators to recover their going forward costs*"⁶ and that outside of complex bids/offers (BM non-energy), "*generators will have the freedom to include any cost they deem necessary (subject to the requirements of REMIT) within their COD*"⁷. Furthermore, the SEM Committee has also stated that "*[a] necessary incident of competition is that inefficient market participants do not recover their inefficient costs*"⁸ but also that, for certain generators (e.g. those who largely operate to meet system constraints) a targeted mechanism that would provide the generator with additional revenue through such a mechanism may be required to assist the generator recover additional, efficiently incurred costs, for system security reasons⁹.

In summary, the SEM Committee seems to be admitting that competitive market behaviour may be different depending on the market and that the proposed market may signal the closure of units required for system security, by erroneously determining that their costs are inefficient and preventing such an outcome through the use of separate non-market payments to meet their efficiently incurred costs. This outcome was not unforeseen and it is symptomatic of a wider issue with the I-SEM market design, namely the SEM Committee's interference in markets to bring about a specific outcome (i.e. wholesale prices lower than in SEM) instead of promoting effective competition to the benefit of customers and allowing all generators the opportunities to finance their licenced activities; i.e. recover their total costs. Ultimately, the market(s) should determine the fate of efficient and inefficient generators alike, with regulatory intervention in market price formation a last resort for addressing identified market failures. Such intervention should be the minimum necessary and proportionate to the issue(s) it purports to resolve. Otherwise, genuine competition should determine value in the market(s) and, create the necessary incentives to ensure that both the short- and long-term interests of customers, efficient generators and the electricity system are best protected.

A market design that envisages non-market side contracts from its inception to correct for market failures, is a market design designed to fail. This is particularly

⁴ SEM/16/024 at para 8.13.1

⁵ Ibid at para 8.17.5 but subject to the caveat that ex-ante controls may be introduced if observed behaviour is deemed to warrant it.

⁶ SEM/17/020 at para 3.5.5

⁷ Ibid at para 1.8

⁸ Ibid at para 3.5.2

⁹ Ibid at paras 3.5.7-3.5.14

significant in the context of European energy policy, specifically the Clean Energy Package, particularly where a CRM requiring State Aid clearance is already being relied upon. Notwithstanding the inefficiencies of adopting such an approach, the risks associated with it give rise to serious questions in respect of the SEM Committee's fulfilment of their statutory duties. The SEM Committee decisions SEM/17/020 and SEM/17/022 have furthered Energia's concerns with respect to the new market design and the conclusions of this response do nothing to assuage these concerns or wider concerns regarding the SEM Committee's flawed competitive premise upon which the I-SEM market design is based.

Finally, it is important to note that the SEM Committee has acknowledged that, despite not having specific local market power provisions as part of the wider market power mitigation approach applied to all generators in SEM, local market power has not been a feature of the market and/or has been successfully controlled by the wider market power mitigation approach.¹⁰ Significantly, and in contrast with the I-SEM proposals, the successful approach in SEM can be characterised broadly as a principles based approach that deliberately avoids a prescriptive approach, favouring flexibility for licensees to comply within a general rubric promoting competition and providing the appropriate opportunities for cost-recovery.

3. A Summary of SEM/17/020

If one leaves aside the change in governance contained in SEM/17/020 for now – this is addressed later in Section 4 – it is relatively easy to summarise the major changes proposed in the decision paper and they are understood to be as follows:

1. A change to the Short Run Marginal Cost (SRMC) definition from reference to total variable generating costs incurred on a trading day to a 1MWh increment or decrement in output during each 30-minute Imbalance Settlement Period (ISP); primarily as it is thought to better reflect the non-energy actions taken in the I-SEM BM.
2. The definition of Opportunity Cost is, in principle, left unchanged as the value of the benefit foregone in using a cost item for the purposes of generation in an ISP. Provision for the inclusion of additional risk to plant and machinery is removed (see 6).
3. The treatment of Gas Transportation Capacity (GTC) costs is assumed to be unchanged from SEM, although this is not clear from the language of either the decision paper (SEM/17/020) or the current consultation paper (SEM/17/026). A plain English reading of both documents would suggest that generators are to be given the flexibility to decide whether or not to include within-day GTC costs in their complex bid offer data.

In the decision paper, the SEM Committee provide their view that “*any GTC purchased within day is an avoidable cost and **can** be included as part of a gas generation unit's complex bid offer data*”¹¹. (emphasis added)

¹⁰ SEM/16/024 at para 7.1.2 and SEM/16/059 at p.13

¹¹ SEM/17/020 at para 9.4.9

Similarly in the proposed BMPCoP, the SEM Committee's proposed approach to "Incremental Gas Transportation Costs" is as follows:

20. *If the fuel cost calculation method referenced in paragraph [18] uses a gas price index that is outside of the Island of Ireland, then the fuel cost calculation **may include** an element to account for relevant incremental gas transportation costs associated with shipping gas from the outside pricing hub to the relevant wholesale gas pricing point in the Island of Ireland, based on published transportation tariffs or, where relevant, the price of gas transportation capacity traded on secondary markets.*
21. *The incremental exit gas transportation costs, at the point of consumption, that is required for the generation of an additional unit of output, **can** also be included.*¹² (emphasis added)

Given the risks of predatory pricing associated with providing such flexibility to generators and the inconsistency of such an approach with paragraph 5 of the proposed BMPCoP, Energia considers the correct interpretation, despite the wording, to be to require generators to include GTC costs where they are eligible cost items (i.e. within day purchases and secondary capacity in certain circumstances) but exclude the cost of all other GTC products. This interpretation is the only one consistent with paragraph 5 of the proposed BMPCoP and with competition policy, and therefore we have assumed there to be no material change proposed, from the approach in SEM (BCoP).

4. The treatment of Variable Operation and Maintenance (VOM) Costs is unchanged from SEM.
5. There is a minor change to the treatment of Foregone Revenue, primarily to account for the interaction with the new CRM.
6. Risk is prohibited from inclusion in a licensee's complex bids but the basis for and effect of this change is unclear.
 - a. First, the decision paper ignores the reality that even a cursory examination of the insurance market would reveal; namely that no available insurance policy offers complete protection. Under a typical policy, generators are left exposed for an excess period of c.40 days and /or incur a monetary excess.
 - b. Second, in seeking to convert a truly variable cost (i.e. output related risk of failure) into a fixed cost of insurance, the SEM Committee don't appear to have made any commensurate adjustment to the Capacity Remuneration Mechanism to account for this additional cost; i.e. include this cost in the Net CONE/BNE calculation.
 - c. Third, the SEM Committee's reasoning in paragraph 8.3.8 of SEM/17/020 in relation to units' short-term operation outside of their normal operating

¹² SEM/17/026 – Proposed BMPCoP – paragraphs 20/21

limits is believed to be wrong and this represents a clear risk that is wholly attributable to the operation of the unit.

- d. Finally the SEM Committee's reasoning for the exclusion of risk (i.e. it is uncertain) is both arbitrary and unjustified.

At the very least the point in relation to insurance policy excess gives rise to a residual risk element, the variable proportion of which must be regarded as a SRMC. The risk associated with operation of a unit beyond its normal operating limits is also a SRMC. A separate consequence of the SEM Committee's reasoning is the need for an appropriate adjustment to the Net CONE/BNE calculation. Ultimately, it remains Energia's view that all variable risk to plant and machinery should be capable of inclusion in a unit's SRMC and that the decision to exclude it in SEM/17/020 is both arbitrary and unjustified.

On the basis of the changes outlined herein, it is possible (with the exception of the exclusion of Risk) to characterise these decisions as being relatively minor in the overall context of the changes proposed in the market under I-SEM. Apart from some changes to key definitions, considered to better align the current definitions with the I-SEM BM, the remaining items reflect either proposed changes that were rejected by the SEM Committee or changes made that appear to contain errors and inconsistencies (i.e. risk).

The SEM Committee decisions in SEM/17/020 do little to support the SEM Committee hypothesis that minimal change to the current arrangements is neither possible nor desirable. It is therefore necessary to consider the proposed changes to the BMPCoP against the SEM Committee's purported rationale for change, *inter alia*, the provision of clarity, flexibility and detail for generators regarding the application of the BMPCoP¹³.

4. The Level of Clarity in the Proposed BMPCoP

At the outset, Energia can see no reason for the inclusion of the term "Principles" in the title of the proposed document. The SEM Committee has proposed a highly prescriptive document, it is the antithesis of a principles-based document. In SEM/17/020 the SEM Committee acknowledged both respondents' concerns on the level of prescription and the need to consult on the level of prescription in the draft BMPCoP.¹⁴ However, this important issue is not dealt with in the current consultation and in the form proposed, there is nothing in the current format and content of the proposed BMPCoP, to justify its description as a principles-based document, so that its title is, as the document stands, misleading.

In order to elucidate a number of the points made herein and to bring into sharp focus the claims of the SEM Committee with regard to the need for such a radical approach under I-SEM, it is instructive to assess in some detail the proposed arrangements under the BMPCoP. To assist with this exercise, the proposed

¹³ SEM/17/020 at para 4.1.2

¹⁴ Ibid at para 10.3.2

drafting of the document is juxtaposed with the existing arrangements in SEM; Rol Licence Condition 15 and the BCoP.

Paragraph 1 – corresponds with Paragraph 1 of the BCoP

Paragraph 2 – **new**; but superfluous given the proposed (draft) licence condition

Paragraph 3 – corresponds with Paragraph 3 of the BCoP with the exception of the introduction of treatment of Demand Side Units

Paragraph 4 – corresponds with Condition 15.1

Paragraph 5 – corresponds with Condition 15.2

Paragraphs 6/7 – correspond with Condition 15.3

Paragraphs 8/9 – **new**; merely restate requirements developed and enforced in separate industry documents

Paragraph 10 – **new**; introduces the concept of an exhaustive list of “Eligible Cost Items”

Paragraph 11 – corresponds with Paragraph 10 of the BCoP but also references requirements

Paragraph 12 – **new**; follows on from Paragraph 10 (BMPCoP)

Paragraph 13/14 – as per comments on Paragraphs 11 & 12

Paragraph 15 – **new**; follows on from Paragraph 10 (BMPCoP)

Paragraphs 16-23 – corresponds with Condition 15.5 and Paragraph 8/12B of the BCoP; despite the additional text, the expected approach is unchanged, including with respect to GTC costs.

Paragraph 24 – **new**; decremental bids/offers are a new concept in I-SEM

Paragraphs 25-28 – corresponds with Condition 15.5 and Paragraph 8 of the BCoP; despite the additional text, the expected approach is unchanged

Paragraph 29 – **new**; provides for shutdown costs for Demand Side Units

Paragraph 30 – corresponds with Paragraph 6 of the BCoP

Paragraph 31 – corresponds with Paragraph 7 of the BCoP

Paragraph 32 – corresponds with Paragraph 8 of the BCoP; albeit with the reference to risk to plant and machinery removed

Paragraph 33 – corresponds with Paragraph 9 of the BCoP

Paragraphs 34/35 – **new**; however it is unclear that this inclusion is either consistent with previous SEM Committee decisions and/or drafted in such a way as to provide generators with discretion as to whether to include such costs or not, which would appear to violate the requirement in paragraph 5

Paragraphs 36-38 – corresponds with Paragraph 11 of the BCoP. The inclusion of additional text does not alter the principle conveyed in the BCoP

and is considered to be superficial as it is meaningless to persons without an energy, emissions or time-limited unit and represents business as usual to those that do

Paragraphs 39/40 – correspond with Paragraph 12 of the BCoP

Paragraph 41 – **new**; related to inclusion of Demand Side Units

Paragraph 42 – corresponds with Paragraphs 12A to 12C of the BCoP

Paragraph 43 – corresponds with Condition 15.5 and Paragraph 8 of the BCoP

Paragraph 44 – corresponds with Paragraph 13 of the BCoP

Paragraphs 45/46 – **new**; but the definitions relate to concepts already defined in industry documents and regulatory decisions

The findings of this assessment are stark and troubling in the context of the SEM Committee's decision to reject a minimal change approach¹⁵. In terms of the proposed content of the BMPCoP, excluding governance, it is a minimal change approach. The proposed BMPCoP offers no improvement on clarity, it removes all generator flexibility¹⁶ and, apart from the inclusion of provisions for Demand Side Units and decremental bids/offers, adds only unnecessary detail that duplicates decisions and requirements that exist elsewhere in the I-SEM regulatory framework.

It is wrong to think that the introduction of the “Eligible Costs” concept – i.e. the exhaustive set of costs that the SEM Committee think ought to be included in generators' complex offers – in any way improves clarity. The proposed BMPCoP still contains the vast majority of cost-items over which the SEM Committee appears to have concerns with regard to interpretation and inclusion by generators in their Commercial Offer Data (COD). In terms of flexibility, only the SEM Committee can claim to benefit from this in the proposed arrangements but it is both erroneous and counter-intuitive to equate this approach with the SEM Committee's purported reasoning for the change (SEM/17/020):

4.3.2 The SEM Committee considers the transfer of content from the “Cost Reflective Bidding in the Single Electricity Market” licence condition necessary to facilitate the creation of a dynamic BMPCoP document for I-SEM that can give greater clarity to industry regarding eligible costs, particularly given the evolving nature of energy markets and the growth in new generation technologies.

It would appear from this statement that the SEM Committee considers that its role is to shape the development of the market and effectively act as a gate-keeper with respect to new costs, technologies and market opportunities. Not only is this an unenviable task which would require the SEM Committee to stay ahead of the market but it is also not a task which falls within the regulatory function of the SEM Committee nor is it one which the SEM Committee is in fact capable of discharging.

¹⁵ Ibid at para 4.3.5

¹⁶ This assumes our interpretation of the treatment of GTC costs is correct for the reasons outlined and that this interpretation is to be preferred to the language used in the SEM/17/020 and the proposed BMPCoP

By inappropriately taking up this role, the SEM Committee would only bring damage to customers' welfare, the electricity system and the market.

Experience under the Licence / BCoP framework also shows that generators are better able than the regulators to identify the costs which form part of their short run marginal costs, under regulatory, and indeed Court, supervision. In *Viridian v. CER*, the Supreme Court held that the SEM Committee's interpretation, that the Carbon Revenue Levy was not an SRMC, was not correct on the basis of the wording of Condition 15 of the Licence. Bizarrely this matter has been relied upon by the SEM Committee to seek to justify a move away from the current Licence/BCoP approach. In fact, the approach currently embedded in Condition 15 has been shown to be inherently dynamic, as, unchanged from the date of its introduction, it has proven capable of seamlessly incorporating new costs in changing market circumstances, where it has been permitted to act without regulatory intervention or impediment.

During the development of the SEM market, the SEM Committee expressly excluded GTC costs from SRMC as, at that time, daily/within-day gas capacity products were not available. Within-day capacity products were introduced during the gas-year 2007/08 but it was not until March 2014 (SEM/14/019) that the SEM Committee permitted this cost to be included in generators' bids. As a result of the action/inaction on the part of the SEM Committee that was required to allow the current Licence/BCoP framework to do what it was designed to do – i.e. permit the inclusion of new SRMC cost-items in generators bids – this gave rise to generators incurring tens of millions of euro in unrecovered costs.

In the context of the current consultations and decisions on complex bid offers in I-SEM, views expressed by the SEM Committee on, *inter alia*, Variable Operating and Maintenance (VOM) costs and risk, suggest that the risk of material error by the SEM Committee is both present and significant, particularly given the inability of generators to recover the costs erroneously prohibited or ignored by the SEM Committee in the past.

Despite the impression one may get from the complex offers consultation (SEM/16/059) and decision (SEM/17/020) papers, the SEM Committee have had an almost unfettered power to amend and/or clarify interpretation of the existing Licence/BCoP framework through decision and/or direction. The SEM Committee's contention that different generators interpret these provisions differently, and that in itself this is a criticism of the current framework, it is more correctly described as a failure on the part of the SEM Committee to investigate and act upon such issues as they arose. In addition to the decisions and directions that were associated with the two substantive issues discussed in the preceding paragraphs, the SEM Committee have only sought to clarify a handful of issues by way of consultation and decision/direction since the introduction of the Licence/BCoP arrangements in 2007. This fact leads one to question three specific issues, namely; 1) if the SEM Committee are unhappy with the current arrangements, why have they not sought to change them before now; 2) where the SEM Committee have exercised this power to review/interpret costs, they have been found to be wrong in the cases where they have been challenged, and; 3) one can have no confidence in the SEM Committee's

ability to continually monitor and update the list and treatment of Eligible Costs under the proposed BMPCoP, particularly where the change in governance proposed effectively removes the ability of licensees to challenge erroneous decisions on anything but process.

In light of the foregoing, it becomes glaringly apparent that the central objective of the SEM Committee in deciding upon (SEM/17/020) and proposing (SEM/17/026) these changes, is to change the governance of the existing arrangements in such a way as to, *inter alia*:

1. Frustrate licensees' opportunities to recover costs and realise value, including earning a reasonable rate of return;
2. Frustrate the development of the market and consequent to (1) give rise to security of supply concerns in certain parts of the market;
3. Frustrate and effectively erode licensees' ability to challenge the interpretation of the SEM Committee with respect to the correct treatment of costs;
4. Further frustrate licensees ability to have errors of the SEM Committee corrected, given the already limited purview of judicial review in Ireland and Northern Ireland;
5. Undermine the clarity, certainty and predictability of the conditions governing cost recovery for licensees and frustrate licensees' ability to rely on the clear precedent set out by the Supreme Court in *Viridian v. CER* (re. Carbon Revenue Levy).

Absent the change in governance proposed and the introduction of the exhaustive "eligible costs" concept – itself a further aspect of the proposed change in governance, an embodiment of the erosion of accountability from the regulatory framework – the BMPCoP contains relatively minor changes from the current content and in many places wording of the SEM Licence & BCoP. The arguments made by the SEM Committee rejecting minimal change do not stand up to even rudimentary scrutiny when one compares the proposed BMPCoP with current SEM arrangements; at the very least the SEM Committee should extricate itself immediately from the central role in market development it has created for itself and in doing so ensure sufficient flexibility is afforded to licensees to submit appropriate cost-reflective bids/offers.

5. Other Issues

The items contained in this section are split into two categories; 1) the items contained in the proposed BMPCoP that are unclear and lead to confusion as a result of oversight, drafting error or lack of understanding, and; 2) items that should be considered for inclusion in the proposed BMPCoP, should the SEM Committee persist with this maligned exercise of undermining governance and accountability of regulatory decision making, and attempting to engineer a specific outcome under the guise of a market solution.

Inconsistencies, Errors & Confusion

As already noted in this response, the proposed treatment of at least two cost-items, namely Gas Transportation Costs (para 20/21) and System Services (para 34/35), give rise to two potential issues. First, the drafting proposes to provide generators with flexibility on whether or not to include these costs in their complex offers, which gives rise to concerns over predatory pricing. Second, such flexibility is inconsistent with paragraph 5 of the proposed BMPCoP. Also, no basis is given by the SEM Committee as to why these costs should be treated differently from all other costs in the BMPCoP. The SEM Committee's wording is unclear and problematic.

Furthermore, on the treatment of System Services, it is unclear why this exists in isolation from the other prescribed rules on the treatment of cost items; i.e. under "IV Eligible Cost Items".

There is an inconsistency between the SEM Committee's requirement for price-quantity pairs to be cost-reflective (paragraph 5) and for them to be monotonically increasing (paragraph 9). The requirement contained in paragraph 9 highlights the futility in prescribing an exhaustive set of costs to be included in complex offers, the corresponding bids/offers can and will deviate away from this prescriptive list in order to satisfy this constraint.

The reference to "Relevant Output Level" in paragraph 7 is inconsistent with the definition provided in paragraph 46 of the proposed BMPCoP. One refers to the change from a level and the other to a change to a level. This is unhelpful and unclear, and does not assist licensees in submitting bids/offers.

Notwithstanding the previous discussion of GTC costs, paragraphs 20/21 make no reference to transportation costs for indigenous gas and/or how this is to be reflected in generator's bids/offers. Furthermore, it is unclear why it only references gas transportation costs and does not go on here or elsewhere to describe the treatment of transportation costs for other fuels (e.g. coal or oil). Again, given the purported focus of this document is to provide clarity and detail to licensees, this section is unclear and does not assist licensees in submitting bids/offers.

Paragraph 18 of the proposed BMPCoP highlights a number of issues with the SEM Committee's proposed approach and apparent understanding of the wider market. First, there is no available real-time fuel price index for a licensee to choose to incorporate into their own fuel cost calculation method, as would be required under the SEM Committee's proposed approach. If one assumes that this is an oversight on the part of the drafters, then it necessitates the inclusion of fuel-price risk into the fuel cost calculation method. The SEM Committee's views on the inclusion of risk to plant and machinery have been discussed elsewhere in this response but the proposed fuel cost calculation method is ambiguous as to what can or might be included. This is again unhelpful and does not provide clarity or detail to licensees and will likely give rise to anomalous approaches to complex bid/offer formation.

Although this is not an exhaustive list of issues with the proposed document, the issues highlighted herein go to further reinforce the conclusion of the previous section of this response, namely that the SEM Committee have done little to further

the purported objectives of the BMPCoP and, with the exception of governance, are considered to have made minimal changes from the existing regulatory arrangements. It is the proposed change in governance that elevates all of these proposed changes to a high-risk status.

Items to be Included

As well as the difficulties with the text of the BMPCoP as drafted, the attempt by the SEM Committee to create an exhaustive list of costs, defined as “Eligible Costs”, creates an additional problem for licensees, in that it becomes necessary that these prescribed processes, procedures and Eligible Costs, cover all eventualities. Energia considers this to be an impossible task for any regulator to undertake and, following on from our response(s) to SEM/16/059, we maintain our opposition to this approach as one which must fail when judged against any objective assessment of a generator’s costs. The issues are particularly acute in the near real-time operation of the Balancing Market and Short Notice Actions by the TSOs.

A number of examples of necessary additions are included herein; it is in no way to be considered to be an exhaustive list.

For units capable of multi-mode operation, arrangements have to be put in place to ensure that the costs that arise for a generator are covered by the market. If a generator is called in the Balancing Market (non-energy) and the generator has been forced to fuel-switch or operation in open-cycle, as opposed to combined-cycle mode, it is not possible at that stage to change the units Technical Offer Data (TOD). This issue gives rise to material risks for the generator, many of which vary with the units output, but it also highlights the futility of the SEM Committee’s proposed approach to seek to define an exhaustive list of costs that cannot be universally applicable.

Clarification of the treatment of gas market imbalance and overrun capacity charges must also be included in the proposed BMPCoP. Given the timeframes associated with the Balancing Market (non-energy), generators may unavoidably incur significant costs in relation to gas commodity and capacity utilised during the period of hours at the end of the gas day (‘deadband period’) when flows cannot be (re)nominated to GNI or may be prohibited from being (re)nominated by GNI/NG and/or gas capacity cannot be booked with GNI within day. Such costs are undoubtedly eligible costs but they have not been addressed in the proposed BMPCoP and gas-fired generators require clarity on this issue.

This issue in respect of the deadband period towards the end of the gas day, also gives rise to the need for the inclusion of decremental bids/offers in respect of a unit’s No Load Costs. The matter arises where a unit is unexpectedly turned down from their expected profile during the deadband period and it serves to further highlight the futility in the SEM Committee’s proposed approach to universally apply an inflexible ruleset to a nonsingular set of real world constraints. The outcome cannot consistently be cost-reflective.

Notwithstanding the views of the SEM Committee on the interaction of these complex bidding rules in the Balancing Market (non-energy) with the Capacity Remuneration

Mechanism (CRM) in SEM/17/020, the approach proposed in the BMPCoP can cause a significant problem for generators who hold a Reliability Option (RO). Given a scheduling decision by the TSO can expose a generator to the large costs associated with not meeting its RO obligation, it is necessary that such costs (or a risk-based proportion thereof) are included in the generator's incremental/decremental complex bids/offers, if the bids/offers are to be cost-reflective.

Finally, it is noted that paragraph 10 of current BCoP has not been incorporated into the proposed BMPCoP. This paragraph provides for an adjustment to a units start-up and no load costs, where it can be demonstrated to the Regulatory Authorities (RAs) that, "the scheduling algorithm and associated software operates in such a way that the bidding of actual start-up and no load costs would distort the true economics of the generation set or unit".¹⁷

Notwithstanding the number of issues highlighted in this section of the response and the wider problem with respect to the treatment of risk addressed earlier in the response, these issues are not an exhaustive list. The potential list of scenarios and provisions required to provide for cost-reflectivity in all scenarios, for all licensees, is likely to be unquantifiable. One statement that can be made with certainty is that the SEM Committee's proposed approach and BMPCoP will not provide for cost-reflective bidding in all scenarios where generators should have the opportunity to recover their SRMC. The proposed definition of a short but exhaustive list of Eligible Costs is removed from reality, it will be wrong in practice and when coupled with the erosion of proper governance arrangements, it will act to the detriment of generators, customers and the electricity system.

While it is necessary to acknowledge that the proposed change in governance is fundamental to understanding the material risks introduced by the SEM Committee's proposed approach in the BMPCoP, it may be possible to mitigate the effects of some of the specific BMPCoP proposals through the introduction of some or all of the following proposals. First, Energia considers it necessary that the SEM Committee introduce an "all other eligible costs" provision and effectively drop the exhaustive list of costs prescribed in the current document. This is consistent with the approach that the SEM Committee have commended in SEM and heretofore has not been challenged by either the RAs or market participants.

In respect of the Eligible Costs provided for, the recent CRM parameters decision (SEM/17/022) provides precedent for an adder type approach; effectively the SEM Committee recognising that their definition of Eligible Costs is unlikely to be exhaustive, an additional adder of [X]% is permitted for generators to include in their complex bids/offers.

Finally, if the SEM Committee do not introduce an "all other eligible costs" clause into the relevant sections of the BMPCoP, then it is considered necessary that two further changes are made to the document. First, under the Change Management provisions (paragraph 44), a mechanism should be introduced whereby licensees

¹⁷ SEM/14/019 at para 10

can call upon the SEM Committee to hold a timely consultation on a the treatment of a particular cost-item or items that may or may not be already included in the list of Eligible Costs. Second, until such time as a SEM Committee decision on such a matter is published, licensees should not be precluded from including costs, not currently in the list of Eligible Costs, in their complex bids/offers. It simply cannot be the case that generators' cost-recovery is frustrated by regulatory processes and/or delay on the part of the SEM Committee to address specific issues with new or existing costs.

6. Summary & Conclusions

This consultation is based on a false premise that minimal change to the current bidding controls framework cannot be implemented for complex offers in I-SEM. What is proposed by the SEM Committee in this consultation paper is minimal change in respect of the content and wording of many of the existing provisions contained in both Condition 15 of the Licence and the BCoP, albeit amalgamated into a single document, the BMPCoP. The SEM Committee's attempt to define an exhaustive set of Eligible Costs is simply misguided and, ample evidence is presented in this response to highlight the futility of such an approach and to further question the suitability of this with the SEM Committee's statutory duties. The use of the term "Principle" in the title is also misleading.

The SEM Committee's stated objective with the BMPCoP is to replicate competitive bid/offer submissions in situations where sufficient competitive pressure is not always expected to be present. However, the SEM Committee's understanding and view of competition and competitive behaviour is at best confused and is, in any event, wrong. There is no unique "competitive market price" for imperfectly competitive markets and the proposed approach contradicts views expressed elsewhere by the SEM Committee on markets that are deemed to be competitive. By failing to have due regard for basic characteristics of the all-island system, market failures have been in-built into the market design and as such it is a market design designed to fail. The overall objective appears to be to engineer a price outcome, by frustrating market forces, that provides a lower wholesale price of electricity in I-SEM, than the market has largely delivered in SEM.

In order to bring about this outcome, the SEM Committee have proposed a fundamental change in governance. This change is wholly unnecessary in the context of the minimal changes proposed in the content and wording of the BMPCoP vis-à-vis the existing bidding control framework; i.e. Condition 15 and the BCoP. The change is to give the SEM Committee an almost unfettered power to control generators' complex bid/offers in the Balancing Market and insulates them from all but the most limited of challenges on process. Our concern with such an approach is compounded by the past performance of the SEM Committee in addressing issues of the correct interpretation of costs, where their action/inaction in just two matters – Carbon Revenue Levy and within-day GTC costs – have cost generators tens of millions of euros.

Notwithstanding the challenges outlined in this response to the SEM Committee's rejection of a minimal change approach, the BMPCoP as a document is not fit for purpose and requires considerable change if it is to satisfy its purported objectives of providing clarity, flexibility and detail to generators. The document contains numerous errors and inconsistencies that give rise to confusion as opposed to clarity and, if not corrected, would facilitate varied and anomalous interpretations by licensees. In addition to this, and as a direct consequence of the remarkably high level of prescription in the document and the removal of all flexibility for generators to determine their relevant cost-items, specifically through the inclusion of an exhaustive list of Eligible Costs, the document fails to make provision for costs that should be included on the list of eligible costs that legitimately arise as SRMC costs for licensees in various circumstances but which licensees could not recover under the proposed BMPCoP. The SEM Committee approach is inconsistent with the principle of cost-recovery for generators in any wholesale electricity market.

If an appropriate governance structure was retained, the command and control position in the Balancing Market sought by the SEM Committee would be unenviable; they would be committing to staying ahead of the market and could be challenged for failing to do so. In the proposed arrangements, the SEM Committee can act with relative impunity, to the detriment of generators, and particularly generators that are necessary for system security. Such a substantial transfer of power, as is proposed by the SEM Committee, gives rise to unprecedented regulatory risk for participants.

This consultation paper has emerged from an erroneous premise set forth in SEM/16/059 and confirmed in SEM/17/020 that a minimal change approach to the current bidding control arrangements was not possible or desirable. What is set out in this consultation is minimal change of the content and wording of the existing arrangements, with no appreciable or practical change in the clarity or details provided to licensees. The material change proposed is to governance and consequent to that, the additional control that can be ceased in its absence; i.e. the introduction of an exhaustive list of Eligible Costs. The overly-simplistic assessment of markets, competition and competitive behaviour that purports to underlie the approach to the BMPCoP, is again more about a control of price outcomes, rather than minimising regulatory interference to the minimum necessary to address the market failure. This is once again facilitated by the erosion of governance.

The reference in SEM/17/020 to the possible need for a mechanism to make additional payments to generators to address local system service requirements or local security of supply concerns, highlights a clear failure in the I-SEM market design. It is the market design that is giving rise to this risk of market failure; a proper market design should seek to alleviate such market failures. The Balancing Market is central to a successful the market design and the proposed changes in governance and in the format and content of the BMPCoP will, if unchanged, be central to the realisation of the market failure alluded to. This outcome is predictable and avoidable but not without action from the SEM Committee. A minimal change approach is appropriate, proportionate and effective, and ensures predictability and stability in the regulation of this important market.